EMPLOYEE ABUSE PREVENTION ACT OF 2002 (DURBIN-DELAHUNT) (S. 2798 / H.R. 5221)

The Employee Abuse Prevention Act of 2002 is a package of reforms of the Bankruptcy Code designed to protect employees and retirees from corporate practices that rob them of their earnings and retirement savings when businesses collapse into bankruptcy.

The bill does this in two ways. *First*, it empowers the courts and trustees in bankruptcy to challenge transactions that have stripped assets from the company and to recapture those assets for the benefit of the company and its creditors. *Second*, it ensures that the claims of employees and retirees receive fair treatment vis-a-vis those of other creditors.

I. PRESERVING CORPORATE ASSETS

- ***Enhances the ability of the courts to scrutinize and set aside transactions that strip the company of its assets.***

Section 101 strengthens the ability of bankruptcy courts to invalidate fraudulent transfers made by corporate insiders by lengthening the "reachback" period under current law from one year preceding a bankruptcy filing to four years. It also empowers the courts to review and set aside "excess benefit transfers" made to top management and other corporate insiders while the company was insolvent or as a result of which the company became insolvent.

This section seeks to recapture assets for employees, retirees, and other creditors, adding value to the bankruptcy estate by calling to account those who use the company for their personal benefit. By making excess benefit transfers to corporate insiders subject to set-aside and recovery if the company goes bankrupt, the provision also seeks to prevent corporate managers from engaging in these practices.

- ***Affirms the authority of the courts to "lift the veil" on transactions that move corporate assets off book.***

Section 102 affirms and reinforces the authority of the courts to look through the formalities of sales, leases, or other transactions that move assets "off book" to determine whether, in fact, such transactions are really disguised loans designed to drain assets from the business. Once these transactions are seen for what they really are, the assets can be brought back into the estate for distribution to employees, retirees and other creditors.

- ***Restores to bankruptcy trustees the authority to challenge and set aside pre-bankruptcy transactions that take assets out of the company.***

Section 103 upgrades the status of the trustee in bankruptcy from that of a lien creditor to that of a "good faith reliance purchaser for value". This will have the effect of restoring to trustees in bankruptcy the ability to review and set aside suspect transactions—an ability they enjoyed as lien creditors prior to the recent amendment to the Uniform Commercial Code that narrowed the powers of all lien creditors.

- ***Limits retention bonuses and other excessive payments to corporate insiders and "turnaround" consultants.***

Section 104 places reasonable limits on "retention bonuses" and similar payments made to corporate insiders for the ostensible purpose of preventing them from leaving the bankrupt company. The bill prohibits such payments unless the court finds that the person has a bona fide job offer from another company at the same or greater rate of compensation; the services provided by the person are essential to the survival of the business; and the amount of the payment is not grossly disproportionate to comparable payments made to nonmanagement employees.

The section also prohibits severance pay to insiders unless (a) the payment is part of a program that is generally applicable to all full-time employees; and (b) the amount of the payment is not greater than 10 times the amount of the mean severance pay given to nonmanagement employees during the calendar year in which the payment is made.

Finally, the section prohibits other payments that are outside the ordinary course of business (including payments made to officers, managers, or "turnaround" consultants hired after the date of the filing of the petition) which are not justified by the facts and circumstances of the case.

Taken together with the court's avoiding powers under sections 544, 547, 548, and 549 of the Bankruptcy Code, these provisions would empower the court to return excessive bonuses to the estate, where they would be available to help the company reorganize, or, in the alternative, for distribution to creditors.

- ***Closes a loophole that prevents trustees from avoiding certain pre-bankruptcy transfers.***

Section 105 clarifies an ambiguity in a provision of the Bankruptcy Code that was enacted at the behest of the securities industry to prevent lawsuits against commodity brokers and securities clearing agencies who carry out certain transfers, such as margin payments and settlement payments, on behalf of their clients. Some courts have construed the provision to prevent recovery not only against these intermediaries but also against the ultimate shareholders on whose behalf the transfers are made. The bill closes that loophole by clarifying that the provision protects only the intermediaries whom Congress intended to protect.

II. ENHANCING THE TREATMENT OF EMPLOYEE CLAIMS

- ***Gives employees a claim in bankruptcy for company stock held in employee pension plans.***

Section 201 gives employees and retirees a fourth priority unsecured claim in bankruptcy for the value of company stock which was held for their benefit in an employee pension plan—unless the plan beneficiary had the option to invest the assets in some other way. The value of the claim is measured by the market value of the stock at the time it was contributed to, or purchased by, the plan.

This provides a measure of protection to employees and retirees who are left holding worthless employer stock in their pension plans when the company goes bankrupt because they were not free to choose other investment options.

- ***Raises the cap on wage priority and employee benefit claims.***

Section 202 increases from $4,650 to $13,500 the cap on priority claims that are payable out of the estate for unpaid wages, salaries, or commissions and contributions to employee benefit plans.

- ***Enhances the treatment of claims arising from the failure of the company to meet its fiduciary obligations toward employees and retirees.***

Section 203 treats as allowed administrative expenses of the estate retiree claims arising from violations of the company's fiduciary obligations to an employee pension plan under ERISA. It further provides that the plan or a beneficiary of the plan may recover any unpaid amount of such claims from any property securing an allowed secured claim. Finally, the bill gives such claims priority over all other claims for administrative expenses.

By subordinating the claims of secured creditors to the claims of aggrieved pension plan beneficiaries, this section provides a measure of protection to retirees and creates an incentive for financial institutions to protect their collateral by requiring assurances that the company is living up to its fiduciary obligations.

- **Strengthens *review of pre-bankruptcy terminations of retiree benefits.***

Section 204 provides that whenever retiree benefits have been modified within the 180-day period before the filing of a bankruptcy petition, the court shall appoint a representative to investigate such modifications and shall order reinstatement of the benefits if it finds that the modifications were made in contemplation of bankruptcy and were not essential to the continuation of the business of the debtor.

- ***Enhances the opportunity for employees, retirees, and small trade creditors to be heard in bankruptcy proceedings by reducing the ability of companies to file in jurisdictions with few genuine links to the affected communities.***

Section 205 prohibits a company from filing for bankruptcy relief in a district based solely on (a) the fact that the company is incorporated in the state where that district is located, or (b) the presence of a corporate subsidiary or affiliate in that district. Under the provision, the company would be permitted to file only in the district in which its corporate parent has its principal place of business; or, if its corporate parent does not file a bankruptcy petition, then in the district in which its affiliate with the greatest assets in the United States has its principal place of business (whether or not the affiliate files a petition). The section also amends section 1412 of title 28 to provide that if a debtor corporation files in the wrong district, the court shall dismiss the case or transfer it to a district in which it could properly have been brought.

This provision would help end the practice of "forum shopping" by which companies evade the jurisdiction of local courts and deprive those most affected by the bankruptcy of a meaningful opportunity to participate in the proceedings.

- ***Benefits employees, retirees, and creditors affected by bankruptcy proceedings that are in progress on the date the Act goes into effect.***

Upon enactment of the Act, most of its provisions will be immediately applicable to pending bankruptcy proceedings, so that employees, retirees and creditors who have been harmed can benefit from the protections it affords.